United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

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In The

United States Court of Appeals

For The Second Circuit

FABRIZIO & MARTIN INCORPORATED,
Plaintiff-Appellee-Appellant,

vs.

BOARD OF EDUCATION CENTRAL SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BEDFORD, NEW CASTLE, NORTH CASTLE AND POUND RIDGE, MARS ASSOCIATES, INC., and NORMEL CONSTRUCTION CORP. OF NEW ROCHELLE, a joint venture,
Defendants,

THE BOARD OF EDUCATION CENTRAL SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BEDFORD, NEW CASTLE, NORTH CASTLE AND POUND RIDGE,
Defendants-Appellants-Appellees,

AETNA CASUALTY & SURETY CO., Additional Defendant on the Counterclaim of Defendant Board of Education,
Defendant-Appellee-Appellant.

On Appeal from a Judgment of the United States District Court for the Southern District

BRIEF FOR BOARD OF EDUCATION

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JEFFRY H. GALLET
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On the Brief

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Louis E. Yavner

UNITED STATES COURT OF APPEALS
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FABRIZIO & MARTIN, INCORPORATED,

Plaintiff-Appellee-Appellant

DOCKET NO.
741661

-v-

THE BOARD OF EDUCATION OF CENTRAL SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BEDFORD, NEW CASTLE, NORTH CASTLE AND POUND RIDGE, MARS ASSOCIATES, INC. and NORMEL CONSTRUCTION CORP. OF NEW ROCHELLE, a joint venture,

Defendants-Appellants-Appellees,

THE BOARD OF EDUCATION OF CENTRAL SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BEDFORD, NEW CASTLE AND POUND RIDGE,

Defendant -Appellant -Appellee ,

AETNA CASUALTY AND SURETY CO.,

Additional Defendant on the Counterclaim of the defendant, The Board of Education Appellee-Appellant

On appeal from a Judgment of the United States District Court for the Southern District.

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DEFENDANT APPELLEE'S BRIEF

ISSUES PRESENTED

1. For what damages may a Board of Education in New York State recover from a contractor who rendered services and furnished materials pursuant to a contract which is illegal and void because let in violation of the mandatory requirements of the State's Competitive Statute?

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Louis E. Yavner

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2. Is the Board of Education entitled

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4. Is the Board of Education entitled

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STATEMENT OF CASE

This action was commenced by plaintiff FA

PORATED (FABRIZIO) against defendant THE BOA

SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BE

NORTH CASTLE and POUND RIDGE (BOARD) for

these causes of action stem from a certain writ

RIZIO and BOARD, dated March 17, 1964 (1025a

orders, dated and filed May 5, 1967 and July 6

the Hon. Edward C. McLean, District Judge, fo

illegal, void and of no force and effect (The Mc

BOARD moved for summary judgment dismis

was heard by the Hon. Sylvester Ryan, District

F. Supp 945 (869). FABRIZIO consented to th

third and fourth causes of action. Judge Ryan

2. Is the Board of Education entitled to recover damages for work stoppage and extra completion costs resulting from the failure of the contractor to complete the construction of the school?

3. May the Board of Education recover the sum representing work originally called for in the specifications which the public never received?

4. Is the Board of Education entitled to a ruling that the contractor and bonding company are responsible for the defense of related State actions brought against the Board by other prime contractors and subcontractors and/or for any judgments payable in them?

STATEMENT OF CASE

This action was commenced by plaintiff FABRIZIO & MARTIN, INCORPORATED (FABRIZIO) against defendant THE BOARD OF EDUCATION CENTRAL SCHOOL DISTRICT NO. 2 OF THE TOWNS OF BEDFORD, NEW CASTLE, NORTH CASTLE and POUND RIDGE (BOARD) for six causes of action. All of these causes of action stem from a certain written contract between FABRIZIO and BOARD, dated March 17, 1964 (1025a). By three decisions and orders, dated and filed May 5, 1967 and July 6, 1967 (66 Div. 2935) (70a), the Hon. Edward C. McLean, District Judge, found that that contract was illegal, void and of no force and effect (The McLean decisions).

BOARD moved for summary judgment dismissing the complaint. The case was heard by the Hon. Sylvester Ryan, District Judge, and reported on 290 F. Supp 945 (869). FABRIZIO consented to the dismissal of its first, third and fourth causes of action. Judge Ryan granted BOARD summary judg-

ment striking out the remaining three causes of action.

Judge Ryan directed a trial in the instant action for a determination of the damages which the BOARD suffered as a direct consequence of the illegal contract.

BOARD'S answer sets forth two counterclaims:

The first, based on the McLean decision, alleges the illegality of the contract and demands refund of $2,131,859.00 paid by BOARD to FABRIZIO of performance under the March 17th agreement, together with accrued interest.

The second is for damages resulting from FABRIZIO'S failure to substantially complete construction of its Middle School in the sum of $410,000.00. That counterclaim was amended in the pre-trial order (Par. 1 (a)) (130a) to the sum of $496,890.00.

FABRIZIO, in its reply, sets forth five affirmative defenses (the last of which was added by Par. 1 (b) of the pre-trial order (131a), and a set-off to BOARD'S counterclaims, alleging that BOARD was indebted to FABRIZIO in the sum of $2,829,283.06, of which only $2,120,756.91 had been paid, leaving a balance due and owing of $708,526,15. That counterclaim and set-off rests essentially on a quantum meruit theory.

The headings to FABRIZIO'S second and third defenses contained in its reply were amended by the pre-trial order (Par 1 (c)) (132a) to provide that they are set-offs as well as defenses. Both of those set-offs essentially allege that BOARD acted fraudulently to the damage of FABRIZIO and that BOARD was estopped from asserting the illegality and unenforceability of

illegal and that as a result the bond was void and of no effect.

AETNA moved for summary judgment before the Hon. Inzer B. Wyatt, District Judge, dismissing the complaint on the ground that the surety has no obligation where the contract guaranteed is void for illegality. That motion was granted (68 Civ. 1162).

Judge Wyatt's decision was appealed to the United States Court of Appeals, Second Circuit (453 F. 2d 264). The Court of Appeals reversed Judge Wyatt's decision and remanded the case to the District Court, with instructions to consolidate it with the instant action, making AETNA an additional party defendant with respect to BOARD'S counterclaims against FABRIZIO. (119a)

In the pre-trial order AETNA amended its answer to incorporate the affirmative defenses and set-offs of FABRIZIO'S reply to the counterclaims of BOARD. In addition, it set forth an additional affirmative defense, set-off and counterclaim that BOARD withheld and concealed material facts from AETNA; that AETNA paid pursuant to its labor and material bond the sum of $114,396.86 to suppliers and subcontractors; that AETNA suffered additional losses and expenses in the sum of $55,503.39; and that all of its losses were suffered as a result of a fraud committed by BOARD in concealing that information, damaging AETNA in the total sum of $169,900.25. (133a)

In the pre-trial order BOARD raised an additional issue:

> "Included in the delay damages sought by defendant BOARD are those, if any, that may result from actions brought by the three prime contractors against defendant BOARD in the Supreme Court, County of Westchester, in which defendant BOARD has brought in plaintiff FABRIZIO and additional defendant AETNA as third party defendants."

In addition to asking that AETNA and FABRIZIO be held responsible State actions and for any damages payable inthem, BOARD also demanded that FABRIZIO and additional defendant AETNA be held responsible for the defense of related State actions brought by two sub-contractors of FABRIZIO against BOARD in the Supreme Court, Westchester County, and/or that they be held responsible for any damages payable in them.

At the outset of the trial, Judge Carter refused to consider this issue, holding it irrelevant to the Federal case

During the trial, the BOARD reduced its claim for damages; seeking recovery of $280,796 for its actual expenditures in completion of the project; $171,000 for the value of work, labor and services illegally removed from the original plans and specifications; and $3,000 for an illegal payment made by the BOARD to FABRIZIO.

By judgment filed March 28, 1974, the District Court dismissed the claims of the plaintiff, holding that the contract between the BOARD and FABRIZIO was void and unenforceable since it had been made in violation of the requirements of competitive bidding and the letting of public contracts.

The Court also dismissed the counterclaim of the additional defendant, AETNA, finding that based upon the facts there was no fraud perpetrated against AETNA by the BOARD.

The Court found against the BOARD, holding that the work stoppage and extra completions costs could not be recovered for, in the Court's opinion, they were "not a direct consequence of the illegal contract...(but) ... arose out of a breach of contract..."

The Court also dismissed BOARD'S counterclaim for the value of work, labor and services (in the sum of $171,000.00) illegally removed from the specifications of the project finding that the BOARD was not deproved of the construction and materials and as a matter of equity should not recover on this counterclaim.

The Court below made no ruling as to the BOARD'S claim that AETNA and FABRIZIO be held responsible for the defense of the State actions and for any damages payable in them.

STATEMENT OF FACTS

FABRIZIO and AETNA are Connecticut corporations, BOARD is a corporation organized and existing under the Education Law of the State of New York.

In November 1963 BOARD duly invited bids for the general construction and site work for its Middle School (this procedure was in conformity with N.Y. General Municipal Law Sec. 103 (1)). Six bids were submitted.

The contract was awarded to Rand Construction Co., the lowest bidder ($2,276,800.00), in January 1964. Subsequently, the Rand Co. asked to withdraw its bid because it had made an error in computation. BOARD consented.

The contract was then awarded FABRIZIO, the next lowest bidder ($2,326,900.00). However, FABRIZIO also discovered a mathematical error in its computation, which it claimed had been understated in the amount of $171,000.00. FABRIZIO also asked either to withdraw or correct its bid.

FABRIZIO'S request was followed by a series of meetings, letters and telephone calls between representatives of FABRIZIO and BOARD during which it was decided to change the plans and specifications to compensate for the error. The changes were made with the consent of BOARD, BOARD'S attorney, the architect and FABRIZIO. To effectuate the changes, a change order was signed on March 17, 1964.

At the same time that the change order was signed, BOARD and FABRIZIO entered into a general construction contract which incorporated the change order. Pursuant to the contract, FABRIZIO as principal, and AETNA as surety, executed a performance bond and delivered it to BOARD as obligee. Thereafter FABRIZIO commenced work on the school (finding of fact by United States Court of Appeals, Second Circuit in Board v. Aetna 53 F2d 264).

Article 30 of the agreement of March 17th provided for FABRIZIO to furnish bonds guaranteeing his faithful performance and the payment of all obligations arising on the job. The bonds were to be at BOARD'S expense.

On April 29, 1969, FABRIZIO submitted its first payment requisition and at the top of that requisition were "bond $25,000." "sub-contractor's bond $18,000."

BOARD and FABRIZIO had had a contentious relationship from almost the first day that FABRIZIO commenced work under the agreement of March 17, 1964. The disagreements between the parties culminated in FABRIZIO'S ceasing work and walking off the job on or about January, 1965.

FABRIZIO'S walk-off led the BOARD to take steps to cancel its contract and AETNA was so notified.

There were numerous meetings, letters, and telephone calls attempting to resolve the problems and those various meetings and correspondences resulted in the draft and execution of a supplemental agreement dated March 23, 1965.

This agreement was signed by Edgar J. Van Allsburg, the President of BOARD, Vincent Fabrizio, president of FABRIZIO and R. B. Pratt, Vice President of AETNA. Set forth in the recital to that contract is a statement of the events leading up to that date as agreed upon by the signing parties. That statement is produced verbatim hereafter:

A. The Board and the Contractor entered into a contract dated March 17, 1964 under which the Contractor was to furnish the materials and perform the general construction and site work of the Middle School, Bedford, New York, as shown in drawings and specifications prepared by the Board's architects; The Architects Collaborative (hereinafter referred to as "TAC").

B. The Contract provided for the substantial completion of the work by September 15, 1965.

C. The Contractor entered upon the performance of the Contract in the course of said performance certain disputes and differences arose between the Board and the Contractor.

D. On or about January 8, 1965 TAC sent a telegram to the Contractor stating that it would not issue a Certificate of Payment to the Contractor for its work during the month of December, 1964 inasmuch as the Contractor had failed to comply with various of the terms and conditions of the contract.

E. Thereafter TAC issued a Certificate dated January 2., 1965 certifying causes for the Board to terminate the Contract, including the Contractor's failure to provide enough work and materials to maintain its construction schedule, its failure to maintain its construction schedule, its failure to make prompt payment to its sub-contractor San Marco Construction Corporation, and its disregard of various instructions issued by TAC.

F. On January 25, 1965 the Board held a meeting attended by the Superintendent of Schools, counsel to the Board, the Contractor, counsel to the Contractor, representatives of TAC, counsel to TAC, and a representative of Aetna Casualty and Surety Company (hereinafter referred to as "Surety"), the Contractor's bonding company. At this meeting there was a general review of the reasons for TAC'S telegram to the Contractor dated January 8, 1965 and of the Contractor's defense of the charges made in that telegram.

G. Upon refusal of TAC to certify payment of the Contractor's requisition for the month of December, 1964 the Contractor protested said refusal to certify and the consequent nonpayment, and thereafter suspended performance of its work under the contract.

H. On February 4, 1965 TAC further certified that the Board had cause for terminating the Contract on the ground that the Contractor had left the job on January 21, 1965, and had not resumed construction, contrary to the conditions of the Contract.

I. Notices of the aforesaid Certificates were duly given to both the Contractor and the Surety, both in person at the meeting of the Board held on January 25, 1965 and by letter dated February 5, 1965.

J. By its letter of February 5, 1965 the Board duly gave notice to the Contractor of its intent to terminate the Contract in accordance with provisions hereof.

K. Since then the Board and the Contractor have engaged in conferences looking towards a resolution of the disputes between them and the resumption of work.

L. On February 13, 1965 the Board held a meeting attended by the Superintendent of Schools, counsel to the Board, the Contractor, counsel to the Contractor, representatives of TAC, counsel to TAC, representatives of San Marco Construction Corporation and counsel to San Marco Construction Corporation. At this meeting the Contractor and its counsel offered to submit a proposal for the Board's consideration in determining whether to permit the Contractor to resume operations.

M. On February 15, 1965 the Contractor's counsel wrote to the Board's counsel confirming that the seven-day notice of termination of contract was extended without prejudice to the rights and obligations of the Board and the Contractor, in order to enable the Contractor to submit certain proposals and revised construction schedules for review by the Board.

N. Such proposals and schedules were thereafter submitted, and, after further review and negotiation, led to this Supplemental Agreement."

The Supplemental Agreement ostensibly settled the differences between the parties under the original Agreement and provided for specific completion dates and liquidated damages. That Agreement differed from the previous Agreement in that AETNA was a party to it. The Agreement was signed by AETNA'S resident vice-president and resident agent State of New York. R. B. Pratt. In that Agreement AETNA consents to being bound by terms and conditions of both the contract and the Supplemental Agreement in consideration of BOARD'S forebearance in exercising its rights against AETNA and FABRIZIO.

On or about March 5, 1966, FABRIZIO stopped all work on the Middle School and walked off the job site.

POINT I

THE PUBLIC MAY SUFFER NO DAMAGES AS A RESULT OF THE ILLEGAL CONTRACT

a) The general rule in New York is that the municipality can recover from the contractor all amounts paid under the illegal contract.

It is well established law in the State of New York, and in most other jurisdictions as well that where the mandatory requirements of competitive bidding statutes have not been complied with, not only may there be no recovery by the contractor, either on the contract or in quantum meruit, (Gerzof v. Sweeney, 22 N. Y. 2d 297, supra, at p. 304; Jered Contr. Corp. v. New York City Tr. Auth., 22 N. Y. 2d 187, 192; 15 Williston, Contracts [3d ed.], Sec. 1786A; Ann., Municipality - Quasi-Contract Liability, 33 ALR 3d 1164, 1172; Restatement, Contracts, Sec. 598). But the municipality can recover from the vendor all amounts paid under the illegal contract (Gerzof v. Sweeney, supra, at p. 305).

The reason for this harsh rule, which works a complete forfeiture of the contractor's interest, is to deter violation of the bidding statutes. S. T. Grand, Inc. v. City of New York, 32 N. Y. 2d 300 at 305, Gerzof v. Sweeney, supra, at p. 305; Jered Contr. Corp. v. New York City Tr. Auth., supra, at pp. 192, 193.

As the Court said in Jered:

> "The continuing growth of our cities and the expansion of governmental services on all levels has necessitated, over the years, the letting of greater numbers of public contracts. While the amount of money involved in these contracts was relatively small a few decades ago, today the amount is astronomical. It is, therefore, a matter of grave public concern that there be absolute honesty in the procuring

> of a public contract. If we are to effectively deter the unscrupulous practice of fraudulent and collusive bidding on public contracts, we cannot look alone to existing penal sanctions. The nature of the wrong is such that it is not easily discovered but, when it is, we make it quite clear that courts of this State will decline to lend their aid to the fraudulent bidder who seeks recover" (at p. 193).

The purpose of bidding statutes is to protect the public treasury, especially in an era in which the amount of money involved has become "astronomical."

The sanctity of the bidding statutes is so jealously guarded because of the damage the public might suffer were they to be violated. The public must not be allowed to suffer any damage by reason of a violation of the public bidding statutes.

b) <u>The Court of Appeals, in Gerzof v. Sweeney created an exception to the general rule of complete forfeiture</u>.

In <u>Gerzof v. Sweeney,</u> the Court of Appeals created an exception to the general rule - which called for a complete forfeiture of the contractor's interest including the return to the municipality of all amounts paid under the illegal contract - based upon the unusual circumstances of that case.

Judge Fuld eloquently reaffirmed the New York rule that in order to preserve the sanctity of the public bidding statutes, a contractor who is party to an illegal contract, must be punished for his participation regardless of either his culpability or the misconduct of the public officials involved. (In <u>Gerzof</u> there was a suggestion of collusion and improper dealings by the public officers involved). In reaffirming that principle, the Court of Appeals held that a penalty of $750,000 was offensive to

the conscience, but that a severe penalty was necessary. The essence of the Court's opinion at pp. 304-305, was:

> ". . . We have repeatedly refused, in such cases, to allow the seller to recover payment either for the price agreed upon or in quasi-contract. One of our salient purposes in adopting this rule has been to deter violation of statutes governing the spending of public moneys for goods and services. The restrictions imposed by such legislation, we recognized, are designed as a safeguard against the extravagance or corruption of officials as well as against their collusion with vendors. If we were to sanction payment of the fair and reasonable value of items sold in contravention of the bidding requirements, the vendor, having little to lose, would be encouraged to risk evasion of the statute; by the same token, if public officials were free to make such payments, the way would be open to them to accomplish by indirection what they are forbidden to do directly. (see, e.g., Albany Supply & Equip. Co. v. City of Cohoes, 18 N.Y.S. 2d 207, 224 N.E. 2d 716, affg. 25 A.D. 2d 700, 268 N.Y.S. 2d 42; Seif v. City of Long Beach, 286 N.Y. 382, 387-388, 36 N.E. 2d 630; People ex rel. Coughlin v. Gleason, 121 N.Y. 631, 717, 25 N.E. 4; Dickinson v. City of Poughkeepsie, 75 N.Y. 65, 74-75; McDonald v. Mayor, etc., 68 N.Y. 23, 28; Lutzken v. City of Rochester, 7 A.D. 2d 498, 184 N.Y.S. 2d 483; cf. Jered Contr. Corp. v. New York City Tr. Auth., 22 N.Y. 2d 187, 292 N.Y.S. 2d 98, 239 N.E. 2d 197.)

> "There should, logically, be no difference in ultimate consequence between the case where a vendor has been paid under an illegal contract and the one in which payment has not yet been made. If, in the latter case, he is denied payment, he should, in the former, be required to return the payment unlawfully received -- and he should not be excused from making this refund simply because it is impossible or intolerably difficult for the municipality to restore the illegally purchased goods or services to the vendor. In neither case can the usual concern of equity to prevent unjust enrichment be allowed to overcome and extinguish

the special safeguards which the Legislature has provided for the public treasury. Although this court has not had occasion to pass on the question, appellate courts of at least two other states have so decided, holding that the vendor must pay back the amount received from the purchaser even though the items sold are not capable of being returned (see County of Shasta v. Moody, 90 Cal.App. 519, 523-524, 265 P. 1032; McKay v. Town of Lowell, 41 Ind.App. 627, 638, 84 N.E. 778), and we strongly favor this view. Only thus can the practical effectiveness and vigor of the bidding statutes be maintained.

"There was, therefore, justification -- and precedent -- for Special Term's decision directing Nordberg to repay the full purchase price of $757,625 and allowing the Village to retain the machinery which had been installed and was in operation. We conclude, nevertheless, though the patently illegal conduct of the defendants entitles them to little consideration, that the amount to be awarded should be less than that. We may adopt this course, in the unusual circumstances of the present case, without disturbing the salutary rationale and policy underlying such decisions as Albany Supply & Equip. Co. v. City of Cohoes. 18 N.Y.2d 968, 278 N.Y.S.2d 207, 224 N.E.2d 716, affg. 25 A.D.2d 700, 268 N.Y.S.2d 42, supra. The sheer magnitude of the forfeiture that would be suffered by the defendant Nordberg, as well as the corresponding enrichment that would enure to the Village of Freeport, under Special Term's determination adds an element to this case not to be found in any of those in which the principles we have been discussing have been applied.

"Ordinarily, the application of the law to particular cases may not, of course, vary with the sums involved. But we must recognize that the rule with which we are concerned has unique aspects that make it appropriate for us to take into account the severity of its impact in cases as extreme as the present one. The purposes of our competitive bidding statutes may be fully

vindicated here without our rendering so Draconian a decree as to subject the defendant Nordberg to a judgment for over three quarters of a million dollars. Justice demands that even the burdens and penalties resulting from disregard of the law be not so disproportionately heavy as to offend conscience."

The Court refused to allow the contractor to refund only its profit and selling expenses saying, at pp. 306-307:

". . . This would result in the entry of a judgment against [contractor] of about $65,000 which, the defendant states, is what the court 'could presume to be a reasonable profit plus selling expenses.' Such a disposition, which would do little more than deprive the seller of its profit, would reduce to negligible proportions the hazard of selling to a municipality in violation of the bidding regulations."

The Court of Appeals therefore fashioned an equitable remedy for Nordberg in Gerzof because of the unusual circumstances of that case.

However, the equitable powers of the Court were not invoked to sanction disregard of competitive bidding statutory safeguards and restrictions nor did the public suffer any damage as a result of the illegal contract. The Court reaffirmed the overriding policy of the Legislature and Courts to provide "special safeguards . . . for the public treasury." The Gerzof decision is a shield for the public agency and a sword for the public.

c) New York case law does not permit the fashioning of an equitable remedy under which the public would suffer damage as a

result of the illegal contract.

Under the Gerzof exception to the general rule - that the municipality may recover from the contractor all amounts paid under the illegal contract - the Court has the discretion to fashion an equitable remedy which will punish the contractor for breaching its affirmative duty not to enter into illegal contracts and so preserve the sanctity of the public bidding statutes.

The Court did not upset the principal that the public, as a matter of public policy, may suffer no damages as a result of the illegal contract, but emphasized that the "public treasury" must be protected.

The Court of Appeals in Gerzof took the position that the village must be made whole in every way.

There is no exception to the rule, as set forth in the cases determined prior to Gerzof, and as reaffirmed by the Court of Appeals in Gerzof, that the public must receive at least what it contracted for, or what it would have contracted for had there been no illegality. (See, e.g. Albany Supply & Equip. Co. v. City of Cohoes, 18 N.Y. 2d 968, 278 N.Y.S. 2d 207, 224 N.E. 2d 716, affg. 25 A.D. 2d 700, 268 N.Y.S. 2d 42; Seif v. City of Long Beach, 286 N.Y. 382, 387-388, 36 v. City of Long Beach, 286 N.Y. 382, 387, 388, 36 N.E. 2d 630; People ex rel. Coughlin v. Gleason, 121 N.Y. 631, 717, 25 N.E. 4; Dickinson v. City of Poughkeepsie, 75 N.Y. 65, 74-75; McDonald v. Mayor, etc.

68 N.Y. 23, 28; Lutzken v. City of Rochester, 7 A.D. 2d 498, 184 N.Y.S 2d 483; cf. Jered Contr. Corp. v. New York City Tr. Auth, 22 N.Y.2d 187, 292 N.Y.S.2d 98, 239 N.E. 2d 197.)

In the instant action the public would suffer damage if it received less than the school building proposed in the original plans and specifications submitted for bidding, at Fabrizio's bid price.

d) The law of this case requires that the BOARD recover all of the damage it suffered as a direct consequence of the illegal contract, including but not limited to the items enumerated by the Court of Appeals in Gerzof.

Judge Ryan in his decision denying BOARD'S motion for summary judgment upon its counterclaims, relied heavily on the opinion of the Court of Appeals in Gerzof. He summarized his opinion as follows:

> "In sum, we hold that any claim or defense resting on the illegality of the contract is available to defendant (BOARD); that it may not plead breach of the prime contract or supplemental agreement or release or waiver under either or failure to present the verified claims; and that the issues remaining for determination of the damages which the BOARD suffered are a direct consequence of the illegal contract, including but not limited to, the items enumerated by the Court of Appeals in "Gerzof"." (Emphasis added).

Judge Ryan went on to say:

> "However, insofar as the BOARD seeks to recover damages incurred by it in being compelled to complete the School, it may well appear at trial that this is an item of damage recoverable under "Gerzof"."

As Judge Ryan stated the public may go beyond the illegal agreement to press its damages. The contract may only be part of the illegality.

The question then becomes; What damage did the BOARD suffer as a direct consequence of the illegal contract?

In determining the measure of damages the Court is bound by the New York law which has set forth the following guidelines:

1) The public may suffer no damages as a result of the illegal contract;

2) Under Gerzof the Court may fashion an equitable remedy, where the circumstances of the case require.

However, it cannot be gainsaid that the special tone of Gerzof is to apply special standards where the fisc is involved. Under Gerzof the remedy must be "severe" enough to protect the sanctity of the bidding statutes without being "offensive to the senses", provided the public is allowed to suffer no damage as a result thereof.

The Court of Appeals had an opportunity to remark upon its decision in Gerzof in S.T. Grand, Inc. v. City of New York, supra. The Court stated, at page 306, that:

"In Gerzof, we had a fair idea of the damage which the village had suffered because of Nordberg's machinations, since the village had already determined that it needed a new generator and there had been one round of legitimate bidding, from which they developed a responsible low bid."

In Gerzof two bids were received, one from Enterprise for $615,685.00 and one from Nordberg for $673,840.00. The Village Board of Trustees accepted the Enterprise bid but before they could act a new Mayor and two new Trustees were elected who subsequently accepted Nordberg's higher bid and awarded the contract to Nordberg. Enterprise was able to have the award set aside but the new Board of Trustees had specifications drawn up for a larger generator, specifications prepared so as to make it impossible for anyone but Nordberg to bid on them. Nordberg's new bid of $757,625.00 was accepted and the generator installed and the contract price paid.

The Court of Appeals concluded that the contract was illegal and void and directed Nordberg to return $178,636.00 of the contract price to the village.

As the Court said in S. T. Grand, Inc., supra at p. 306:

> "This figure represented damage which the village suffered by having to take Nordberg's larger and more expensive generator. The damage figure was arrived at by adding to the difference between the contract price and Enterprise's original low bid ($141,940), the increased cost of installation of a larger generator ($36,696). In short the village was put in a position it would have been in had the original Enterprise low bid been accepted."

In the instant action, as in Gerzof, we have a fair idea of the damage which the public has suffered since the School Board had already determined that it needed a new school and there had been one round of legitimate bidding, from which there developed several responsible bids.

The undisputed facts in this action show that the three lowest bids for the general construction and site work for the BOARD'S school were as follows:

Contractor	Base Bid
Rand Construction Company	$2,276,800.00
Fabrizio & Martin, Inc.	$2,326,900.00
Walter A. Stanley Construction Company	$2,549,000.00

Subsequently, Rand Construction Company asked to withdraw its bid and the BOARD consented.

FABRIZIO also discovered a mathematical error in its computation, which it claimed had been understated in the amount of $171,000.00. Rather than withdrawing or correcting its bid, FABRIZIO accomplished the same result by omitting work called for by the original plans and specifications in the sum of $171,000.00.

As Judge McLean said in his opinion, (94a):

> "The work that Fabrizio was called upon to perform was different from that which all the other contractors were asked to bid on. No one can say with certainty that if these modified plans had been made available to all would be bidders, one of them would have bid a lower figure than Fabrizio's $2,326,900.00. On the other hand, no one can say with certainty that this would not have occurred. The intent of the statute is that all bidders are entitled to an equal opportunity."

The Court, in fashioning an equitable remedy under the Gerzof guidelines, now has a fair idea of the damages which the public has suffered. The measure of damages is the difference between the actual cost to the public of the work submitted in the original plans and specifications and the original bid of FABRIZIO in the sum of $2,326,900.00.

Only by assessing such damages will the public be made whole, the prime directive of Gerzof; only by assessing such damages will the New York rule that the public must not be damaged by the illegal contract be complied with; only by assessing such damages will the Court deter violation of the bidding statutes.

The computations of the BOARD'S costs for completion of the general construction and site work are painstakingly set forth in defendant's Exhibit 99 in evidence (1051a).

The computations of BOARD's claims are painstakingly set forth in defendant's Exhibit 99 in evidence.

Extra cost for the Clerk of the Works	$ 7,549.
Additional Insurance Premiums for 8 months	1,800.
Additional Architect's fees	21,358.
Payments to FABRIZIO	2,126,756.
Loss on FABRIZIO Retainage Bonds	5,103.
Payment to Mars-Normel	428,164.
Payments to McNamee	102,017.
Payments to Bradhurst	29,329.
Payments to FABRIZIO's sub-contractors and disbursements made for contract reletting	85,051.
TOTAL	$ 2,807,127.

The BOARD was therefore required to spend $480,227.00 more to complete its school than called for under FABRIZIO'S original bid.

In addition, the BOARD was required to let first bond anticipation notes and eventually bonds in the amount of $250,000.00. The interest schedules for those notes and bonds are fully set forth in defendant's Exhibit 95 in evidence (D-93R) and come to $49,049.00 for the notes and $125,749.00 for the bond, leaving a total interest factor of $174,798.00. As an additional cost of constructing the school the public is entitled to recover this amount.

The actual cost for the completion of the general construction and site work to the public, for which the bid price had been $2,326,900.00 was actually $2,981,925.00, a difference of $654,325.00. This does not include the value ($171,000) of the work illegally deleted from the contract.

Even if we take as our basis for damages the next lowest bid after Fabrizio, that of Walter A. Stanley Construction Company, the difference between the bid price - $2,549,000.00 and the actual cost of completion - $2,981,925.00 would leave the public damaged to the extent of $432,925.00. In addition, the Stanley bid included the additional $171,000.00 of work and material deleted from FABRIZIO'S contract. The total damage to the public under those circumstances would be $603,925.00.

The BOARD however, does not seek to recover either of the above amounts. The BOARD seeks damages in the sum of $451,796.00, which includes $280,796.00 for the cost of the completion of the construction of the Middle School and

$171,000.00 as the value of labor and material illegally excluded from the contract between FABRIZIO and the BOARD.

The BOARD arrives at the figure of $280,796.00 by deducting from the total completion costs ($2,807,127.00) the sum of $2,641,697.00, which is the amount of the FABRIZIO contract as of March 1, 1966, including change orders number 15 and 16 (p-1, 2-R). Based upon the analysis (1051a), the increased completion costs for general construction and site work was $165,430.00. Since the BOARD was required to let first bond anticipation notes and eventually bonds in the amount of $250,000.00, of which $165,000.00 is 66%, that portion of the interest is applicable to the increased cost of construction. Whereas the total amount of interest was $174,798.00 (D-93R) the additional amount applicable to the increased cost of construction is $115,366.00, bringing the total cost for the completion to $280,796.00.

The claims of the BOARD are neither penalties nor excessive. The BOARD'S contention that it should be awarded $171,000.00 for the construction value lost, $280,796.00 for its actual out-of-pocket expenditures in completion of the project is eminently reasonable and, if anything, insufficient to meet the Gerzof requirement that the public be made whole and suffer no damage as a result of the illegal contract and Judge Fuld's requirement that the payment be large enought to discourage this contractor and other contractors from entering into agreements in violation of the bidding statutes.

Moreover, the total expenditures and costs to the public have not as yet been determined. At the present time the BOARD is a defendant in several State court actions brought by other prime contractors and subcontractors of FABRIZIO. It is the BOARD'S contention that any liability on the part of the BOARD in these actions is a "direct consequence of the illegal contract". Until those actions are completed it will be impossible to determine the actual cost to the public and the damage it has suffered because of the illegal contract.

The Court below refused to admit any evidence relating to the State court actions. In his decision, Judge Carter made no ruling, as requested by the BOARD, that the contractor and bonding company be held responsible for the defense of related State actions brought against the BOARD by other prime contractors and subcontractors and/or for all judgments payable in them.

The Court erred in failing to admit such testimoney and in failing to give the requested ruling. Any recovery against the BOARD in the State court actions would be damage to the public resulting directly from the illegal contract between the BOARD and FABRIZIO and as a matter of public policy and under the guidelines of the Gerzof decision and the directive of Judge Field recoverable by the BOARD in this action.

The equitable remedy to be fashioned by this Court under Gerzof may not leave the public in a position in which it would suffer damage because of the illegal contract. The decision of the Court below, in denying the BOARD'S claim to the completion costs, the construction value

lost and in refusing to hold the contractor and bonding company liable in the State actions would leave the public in just such a position.

POINT II

THE COURT BELOW ERRED IN NOT GRANTING THE BOARD RECOVERY FOR THE INCREASED COMPLETION COSTS FOR GENERAL CONSTRUCTION AND SITE WORK

The BOARD seeks as part of its damages $280,796.00 for its actual out-of-pocket expenditures for completion of the school project.

In setting this matter down for trial Judge Ryan, relying heavily upon the opinion of the Court of Appeals in Gerzof stated:

> "That the issues remaining for determination of the damages which the Board suffered are a direct consequence of the illegal contract, including but not limited to, the items enumerated by the Court of Appeals in 'Gerzof'."

As to costs for the completion of the school, Judge Ryan went on to say:

> "However, insofar as the Board seeks to recover damages incurred by it in being compelled to complete the school, it may well appear at trial that this is an item of damages recoverable under 'Gerzof'."

In his opinion Judge Carter stated that:

> "What is now open is the factual determination of whether any damages incurred by the Board were a direct consequence of the illegal contract. If so, they could be recovered under the principals established in Gerzof."

Judge Carter recognized that "the illegal acts of the Board do not mitigate the harm to the public resulting from a violation of the law. The public interest is the one which is to be protected, and it is not to suf-

fer because of a wrongdoing of its officials." (1065A).

Nevertheless, the Court ruled that, based upon the evidence, the BOARD could not recover for the expenses incurred in completing the school, holding that "the work stoppage, failure to meet the terms of the contract, the securing of another contractor, and money expended to complete construction were not a direct consequence of the illegal contract." (1066A).

Judge Carter stated that "[w]hat must be stressed is 'the vindication of the competitive bidding statutes and preventing illegality.'" (1066A) In doing so, we must not forget that the purpose of the rule is to protect the public.

What must be stressed is the underlying basis for the New York rule, that the public may not be damaged by the illegal contract. The statutes are designed to protect the public, which must be made whole in every way. This is what the Court in Gerzof had in mind when it authorized damages consisting of the increased price of the illegally installed generator, difference in costs of installing that generator, and the interest paid to finance the purchase of the more expensive generator. The Court can only vindicate the competitive bidding statutes and prevent illegality by first protecting the public from damage and then providing a remedy severe enough to deter contractors from violating the requirements of those statutes. To deny the BOARD recover of these extra completion costs would leave the public damaged in disregard of the

New York rule and would fail to make the public "whole", as required by the Gerzof decision.

Moreover, the Court erred in holding that the completion costs were not a direct consequence of the illegal contract but arose out of a breach of contract by one of the parties.

Not only were the additional construction costs a direct consequence of the illegal contract but damages suffered by the BOARD could only have occurred in connection with the construction of the school.

In the decision on the appeal by the BOARD from the order granting AETNA summary judgment, the Court of Appeals (Moore, C.J.) in analyzing Judge Ryan's decision stated:

> "It is abundantly clear from Judge Ryan's decision that he did not hold that Fabrizio could not under any circumstances be liable to the Board for damages. Damages could only have been incurred in connection with the construction of the school and it was for proper performance of this construction work that Aetna stood surety." (emphasis added)

The BOARD does not ask that its damages be measured as a breach of contract; Judges McLean and Ryan have ruled that so far as FABRIZIO and BOARD were concerned, there was no existing contract. Under the Gerzof rule, which Judge Ryan applies to this case, the BOARD must prove its actual loss, not reasonableness of loss, not the value of services, or any of the other measures of damages normally used in breach of contract actions.

The Court below seemed to have recognized the applicability of this

rule in asserting the BOARD can claim as its damages "what it cost ... to build the building" and that it can talk in terms of "costs" and not in terms of the value of the services performed, which is a quantum meruit argument and not applicable to this case under State law (939a).

The $280,796.00 sought by the BOARD, which includes $165,430.00 as "increased completion costs" and $115,366.00 for thirty years interest are damages which "could only have occurred in connection with the construction of the school" and under the Ryan decision and Gerzof guidelines are damages which occurred as a direct result of the illegal contract. The sum of $165,430.00, as stated by BOARD'S witness Fowler (668 a et seq.), was computed in accordance with the analysis schedule which he prepared (1051a). To substantiate these claims as to the actual "cost of completion" BOARD adduced testimony from Fowler and Craine asserting that this was, indeed, the actual cost to the BOARD of completing the school. This testimony is supported by exhibits, which prove that the BOARD paid these sums upon the architect's certification that these payments were proper. (99R-130R)

Both the Court and counsel for AETNA recognized that Fowler was a qualified witness to testify as to the additional costs to the BOARD for completing the school. Testimony showed that it was Fowler who personally approved the requisitions for payment (348a).

In relation to Fowler's testimony as to the increased cost of construction, the Court stated, at p. 387a:

> "He's indicating this as a cost that the school board had verified by documents.
>
> "As far as I am concerned, unless you show these costs were not made and are not in connection with construction, then it seems to me he has made a prima facie case."

The Court further states, at p.389a, in answer to an objection to Fowler's testimony as to additional costs for completion:

> "He [Yavner] has made a foundation. This man [Fowler] is on the witness stand. He has indicated he was in charge. He is verifying by showing that these were the items of cost."

The attorney for AETNA accepted the Court's decision as to Fowler's qualifications, stating, at p.404a, that the Court had "laid down guidelines that he [Fowler] is entitled to testify as to construction costs."

That this sum represents the actual "additional cost of completion" is substantiated by Crane's testimony. Fowler stated that he relied upon the architect as an expert to certify that the additional sums for construction cost were accurate and reflected the increased cost of construction (485a).

Crane testified that he examined all the documents (requisition for payments for construction work and supporting documents) when they were originally submitted and certified that the required work was done (750a).

Crane also stated that he could determine whether the construction work done had been FABRIZIO's responsibility by consulting the FABRIZIO contract documents and comparing the items required therein with each item of work done. He was therefore able to determine that, of the construction work, only $9,167.25 of the work done by MARS-NORMEL was not chargeable to FABRIZIO, a sum for which the BOARD is not making a claim (566 a).

The Court stated after Fowler presented his schedule which indicated that the increased "cost of completion" was $165,430.00:

> "I suppose the plaintiff's [sic] and the additional defendant still are going to contend and seek to show, as they had yesterday, that in that $428,000 plus $102,000 and $29,000 in costs, and I suppose even the $85 to the subcontractor as to whether or not those items included things other than completing what FABRIZIO had undertaken to do. I suppose that they can show that any of these items are over and above what FABRIZIO undertook to do and we might end up further with production." (673a)

After the ensuing effort by Powers to discredit Fowler's testimony as to the increased completion costs, the Court stated:

> "But in terms of reducing the actual cost of construction, it may well be, and you are certainly entitled to go into it, but the $165,000 figure and the $250,000 new bond issue that you utilized, maybe you can show that that part really is not properly allocated for construction....
>
> But .. I don't think Mr. Powers has ...in any way shown that the $165,000 allocation was inappropriate and did not go to construction." (727a)

No evidence was thereafter adduced which would indicate that this allocation was inappropriate and did not go to construction costs.

Based upon the public policy in the State of New York, the Gerzof decision, the law of this case as set forth by Judge Ryan, and the evidence produced during the trial, the decision of the lower Court denying the BOARD'S claim to recovery of the extra completion costs must be reversed.

POINT III

RESTITUTION TO THE BOARD FOR THE VALUE OF WORK, LABOR AND SERVICES ILLEGALLY REMOVED FROM THE SPECIFICATIONS OF THE PROJECT BY THE IMPROPER CHANGE ORDER EXECUTED CONTEMPORANEOUSLY WITH THE MARCH 17, 1964 CONTRACT MUST BE MADE BY FABRIZIO AND AETNA

The Court below dismissed the BOARD'S claim for $171,000.00 for the value of work, labor and services illegally removed from the specifications of the project on the grounds that:

1) The public was not deprived of $171,000.00 in construction and materials; and

2) The value of the unpaid for services, labor and materials received by the BOARD for which plaintiff seeks recovery of $708,526.50 is far in excess of $171,000.00 in construction and materials deleted from the original plans and specifications.

Based upon the latter statement, the Court below in fashioning its "equitable" solution held that:

"Since plaintiff is not being allowed to recover for any of these unpaid services, labor and materials, and the public has thereby been enriched to that extent, equity would seem best served by not altering the status quo. Hence, recovery by the BOARD of $171,000.00 is denied." (1070a)

Both as a matter of fact and as a matter of law the Court below erred in denying BOARD'S recovery for the construction and materials deleted because of the above stated reason.

As a matter of fact, there was no evidence introduced at the trial to show that the value of the unpaid for services, labor and materials received by the BOARD was $708,526.00. As a matter of fact, the Court specifically excluded any evidence as to the value of the unpaid for services, labor and materials allegedly supplied by plaintiff to the BOARD for which plaintiff seeks recovery of $708,526.15. There is no basis therefore for the Court's finding that the value of the unpaid for services, labor and materials received by the BOARD was $708,526.15. This is merely the amount claimed by the plaintiff and is unsupported by the evidence.

There is no question, however, that as a matter of fact the work illegally deleted was $170,000.00. Judge McLean, in a decision res judicata to BOARD and FABRIZIO, found that the true value of the work deleted was $171,000.00 (See also Pre-Trial order, paragraph 3 (a)(5)). (135a)

Moreover, even had the plaintiff proved the value for its unpaid services was $708,526.15, or any amount in excess of $171,000.00

the Court must, as a matter of law, grant judgment to the BOARD for the amount demanded.

The New York case law is that there can be no recovery in quantum meruit where the mandatory requirements of a competitive bidding statute have not been complied with even though the municipality has received benefits. 10 McQuillin, Municipal Corporations (1966 Rev. Vol.) Sec. 29.4; 6 Wiliston, Contracts (Rev. Ed., Sec. 1786a).

Judge Carter recognized that since all of plaintiff's claims for extra costs and expenses have their origin in the original agreement, they are insufficient in law. (1060a)

The Court in Gerzof specifically points out that contractors may not receive by indirection what they could not have received under contracts specifically declared illegal because of violation of bidding procedures. That rule is true even where the contractor was absolutely innocent and there was a moral obligation of the municipality to pay. Seif v. City of Long Beach, 296 N.Y. 382; Lutzken v. City of Rochester, 7 A.D. 2d 498.

The decision of the Court below has allowed FABRIZIO to circumvent the New York rule by granting the contractor a setoff on a claim which is in essence under the illegal contract.

As to the rationale that the public was not deprived of $171,000.00 in construction and materials, the Court found that in the instant case, unlike Gerzof, the contract called for a lower, not higher price for the construction. The Court went on to state that since the next bid sub-

mitted to do the job originally called for $250,000.00 greater than the FABRIZIO contract the public was not really deprived of $171,000.00 in construction and material. (1070a)

There can be no question but that the school completed contains $171,000.00 less in construction and material than the school originally contemplated in the plans and specifications upon which FABRIZIO submitted its original bid.

As Judge McLean stated:

> "The work that FABRIZIO was called upon to perform was different from that which all the other contractors were asked to bid on. No one can say with certainty that if these modified plans had been made available to all would-be bidders, one of them would have been a lower figure than Fabrizio's $2,326,900.00. On the other hand, no one can say with certainty that this would not have occurred. The intent of the statute is that all bidders are entitled to an equal opportunity."

Judge Carter stated: (1070a)

> "We can only speculate as to whether and to what extent the altered plans and specifications would have produced savings to the public if the requisite bidding had occurred."

It is submitted that any such speculation must be resolved in favor of the public so that it cannot be harmed by the illegal contract and the sanctity of the bidding statutes are preserved.

As a matter of law such speculation cannot be resolved in favor of the contractor. As a matter of fact there can be no question but that the public has suffered damage in that it has received less than it would have received had the intent of the statute been followed and had all bidders been given an equal opportunity.

POINT IV

FABRIZIO MUST REFUND TO BOARD FOR WORK DONE UNDER ALTERNATE NO. 3 ALL MONIES RECEIVED BY IT IN EXCESS OF THE MAXIMUM AMOUNT FOR WHICH THE BOARD WAS EMPOWERED TO ENTER INTO A CONTRACT.

The Pre-Trial order, Par. 3(a) (5) sets forth that the authorized expenditure for alternate no. 3 was $95,000. That paragraph further sets forth that FABRIZIO received payment of $98,000 for that work. In accordance with the rule in Gerzof, supra, the $3,000 excess payment must be refunded to BOARD.

POINT V

THE ADJUDICATION THAT THE CONTRACT OF MARCH 17, 1964 AND THE SUPPLEMENTAL AGREEMENT DATED MARCH 23, 1965 IS ILLEGAL AND UNENFORCEABLE AS BETWEEN FABRIZIO AND BOARD IN NO WAY AFFECTS AETNA'S LIABILITIES THEREUNDER.

Although the Court below found that given the facts of this case there was no deception on the part of the BOARD which constituted fraud as to AETNA, and dismissed the counterclaim of AETNA, the Court failed to reply to the BOARD'S request for relief against AETNA. As Judge Moore said in the opinion for the Court of Appeals reversing Judge Wyatt's decision granting AETNA summary judgment, "Damages could only have been incurred in connection with the construction of the school and it was for proper performance of this construction work that Aetna stood surety."

However, AETNA is not only liable for proper performance of the construction work and damages incurred in connection therewith (e.g. completion costs) but has legal responsibilities under the supplemental agreement.

On March 17, 1964 AETNA issued to FABRIZIO two surety bonds insuring FABRIZIO's performance under the agreement of the same date and payment of FABRIZIO's subcontractors, both to the benefit of BOARD. (53a) Those agreements specifically incorporated the terms and conditions of the agreement between BOARD and FABRIZIO. On March 23, 1965 FABRIZIO, BOARD and AETNA entered into a tri-parte supplemental agreement. Unlike the March 17 contract, the supplemental agreement was signed by AETNA (1036a). The supplemental agreement specifically incorporated its provisions and the provisions of the March 17 agreement in the surety bonds.

Judge McLean in his decisions ruled that the agreement between BOARD and FABRIZIO was illegal and Judge Ryan extended that finding in his decision to the supplemental agreement on the rationale that it flowed directly from the March 17 agreement. Neither of those decisions referred in any way to AETNA.

It is a well established principle of law that a surety is not released from its obligations merely because the contract being insured is declared illegal. American Law Institute Restatement of Contracts, Sec. 601, pp. 1116, 1117; People's Lumber Co. v. Gillard, 136 Cal. 55,

68 Pac. 576 (1902); City of Madison v. American Sanitary Engineering Co., 118 Wis. 480, 95 N.W. 1097 (1903); Phoenix Assurance Company of New York v. City of Buckner, Missouri, 305 F.2d 54, Write of Cert. Den. 371 US 903, 9 L ed. 2d 165, 83 S.C. 207.

Restatement of Contract, supra, sets forth an illuminating example: "A, a municipality, enters into a bargain with B, a corporation in which the official of A who enters into the bargain on A's behalf is a shareholder. The formation of such bargains is made criminal by statute. B gives a bond to A to secure performance of the bargain. The bargain is defectively performed. A can get judgment on the bond."

The facts of the Gillard case, supra, are exactly the same as in our case. The bids were rejected, for they exceeded the sum provided for the building. The plans were changed so as to bring the cost down to the amount provided. A contractor agreed to erect the building for that sum without further advertising, and entered into a contract for the erection of the building according to the changed plans, and executed a bond for the due performance of the contract. Held, that the fact that the BOARD had no authority to make the contract without readvertising for bids did not discharge the sureties from the liabilities created by the bond.

In response to the arguments that "The act [requiring the bond] being void the bond made pursuant to it is void" and that "the right to sue on [a statutory bond] comes along from the statute," the Court declared:

"The bond, no doubt, was made pursuant to the statute. But it was voluntarily made, and may be enforced as a common law bond, as it is, substantially, in form ... No statutory authority is required to give validity to bonds of this character, and, if there were no statute on the subject, it would be quite within the ordinary and prudential administration of the affairs of the school district for the board to require some guaranty by bond or otherwise for the faithful performance of the work. The bond derives force from its provisions, and not from any statute. The argument of appellants is that, the act requiring the bond being void, it follows that the bond is void. It has been frequently held here that, although the contract may be void for some failure to comply with the statute, the bond nevertheless may be enforced. Kiessig v. Allspaugh, 99 Cal. 452, 34 Pac. 106; Summerton v. Hanson, 117 Cal. 252, 40 Pac. 135, and cases cited. The reasons which led to the conclusion in the above cases would seem to apply here. See, also, Metal Works v. Dodge, 129 Cal. 390, 62 Pac. 41."

The surety also claimed that the suit could not be maintained because it was brought on a bond given to secure the performance of the original contract and the evidence showed that the contract was altered after the bond was executed. As to this claim the Court held:

"It appeared that after the bids were all in for the building it was found that they exceeded the money provided, to wit, $7,000, and the bids were all rejected, and the plans were then gone over, and certain changes made to bring the cost down to $7,000, and Gillard and Leary agreed to build the structure for that sum without further advertising, and thereupon the contract in question was made, and the sureties then signed the bond. As to these facts it is sufficient to say that they do not furnish any ground of defense. The bond was executed with reference to the contract annexed to it and not with reference to any advertising proposals. If the board had no authority to make the contract without readvertising for bids, that fact would not discharge the sureties from their obligations under this bond."

The Court also declared:

> "The contract was referred to in the bond, and its provisions must be presumed to have been known to the obligors of the bond."

In the City of Madison case, supra, the Court refused to release the surety where the prime contract had been declared illegal, saying:

> "Conceding that the facts are as claimed, there is a very plain misapprehension here of the application of the principles relied on. Taxpayers whose money is about to be spent, or property owners whose land is about to be charged, may challenge the legality of municipal acts and contracts calling for such expenditures on the ground that the proper legal steps have not been taken, but persons who enter into a contract with the city stand in a different position. Such a person cannot even make the defense of ultra vires or total lack of power on the part of the corporation to make the contract. Security National Bank v. St. Croix Power Co. (Wis.) 94 N.W. 74. If the defense of ultra vires cannot be made, it is very evident that the lesser claim of failure to execute a given power in the statutory way must also be ineffective. By the express terms of the bond the surety company has made the contract a part of the bond. Theyhave contracted with the city, and cannot now be heard to say that the city had no power to enter into the contract or did not make the contract in the required manner."

Judge Moore's opinion for the Court of Appeals, reversing Judge Wyatt's decision granting AETNA summary judgment on the grounds of illegality of the prime contract (supra), specifically removes AETNA's premise of no liability under a void contract. There can be no question but that AETNA is fully liable to BOARD for any and all judgments rendered in BOARD's favor against FABRIZIO

Not only is AETNA liable for such judgments, but also AETNA (though not FABRIZIO) is bound by, and does have legal responsibili-

ties under the supplemental agreement.

Where an agreement grows immediately out of the illegal agreement it cannot be enforced even though it is a new agreement. An exception to this, however, is to permit the enforcement of an agreement indirectly growing out of the illegal agreement. This may occur where the obligation indirectly connected with the illegal transaction is supported by independent consideration so that the plaintiff does not require the aid of the illegal transaction to make out his case.

If the new cause of action is founded upon a distinct and collateral consideration and the plaintiff is not obliged to resort to the illegal agreement in order to maintain the suit, the illegality of the former transaction will not impair or bar the right to maintain the suit. If the new transaction does not depend upon or require the enforcement of the unexecuted provisions of the illegal agreement, it will be carried out. The test is whether, in order to establish his case, the new agreement can be separated from the illegal one and whether the plaintiff must in any way rely upon the illegal transaction (10 NY Jur, Contracts, Sections 173-174).

The agreement of March 17, 1964 was between BOARD and FABRIZIO only. AETNA was then essentially a subcontractor with no direct relationship to BOARD, except that BOARD could conceivably be the ultimate beneficiary of AETNA's agreement with FABRIZIO.

The supplemental agreement was really two separate agreements

(partially evidenced by the fact that AETNA signed on a difference page than FABRIZIO). AETNA entered into a direct contract with BOARD for separate and independent consideration from the prime contract, the consideration being BOARD's forbearance to sue AETNA on the bond. The contract between AETNA and BOARD was not one which required bidding or any other formal procedure, and was within the BOARD's powers under Section 1709, subd. 33 of the Education Law. On the other hand, the section of the supplemental agreement pertaining to FABRIZIO was basically an extension of the illegal agreement and has no independent consideration.

A new independent contract founded on a new consideration, although in relation to property respecting which there had been unlawful transactions, is not itself unlawful. AETNA and the BOARD were not parties in pari delicto in respect to the prime contract. They had a legal right to enter into an independent contract; public policy does not forbid it.

In consideration of the BOARD's forbearance to sue it, AETNA agreed in the supplemental agreement to assume various obligations, if FABRIZIO did not. Two of these obligations were not in the prime contract, do not flow from it, and are wholly independent. They are the new provisions for the specified liquidated damages and for defense of the BOARD in actions brought against it by the three prime contractors other than FABRIZIO, as set forth in the Pre-Trial order.

National Union V. Ins. Co. of Pittsburgh, Pa. v. D & L Const. Co., 353 F.2d 169, 174 (8th Cir. C.A., 1965), holds:

> "Equity makes no favorite of a corporate surety. Contracts are construed most strictly against a compensated surety and in favor of indemnity."

AETNA was compensated. The BOARD paid FABRIZIO, under its first requisition, a total of $43,000 for bonds FABRIZIO obtained in BOARD's behalf (Pre-Trial Order, Par. 37(a)).

Where it appears that the purpose of the bond has failed, and that liability thereon has never attached, the premium which was paid to procure the bond may be recovered from the bonding company. (17 Am Jur 2d, Contractors Bonds, Sec. 43). But this would not be as appropriate relief as to give the BOARD judgment against AETNA, as requested, under the supplemental agreement.

POINT VI

THE BOARD IS ENTITLED TO A RULING THAT FABRIZIO & MARTIN AND AETNA ARE RESPONSIBLE FOR THE DEFENSE OF THE RELATED STATE ACTIONS BROUGHT AGAINST THE BOARD BY OTHER PRIME CONTRACTORS AND SUBCONTRACTORS AND/OR FOR ANY JUDGMENTS PAYABLE IN THEM.

In the Pre-Trial order, the BOARD raised the additional issue that included in the delay damages which it sought are those, if any, which may result from actions brought by the three (3) prime contractors against defendant, BOARD, in the Supreme Court, Westchester County, in which the BOARD has brought in plaintiff, FABRIZIO, and additional defendant, AETNA, as third-party defendants.

The BOARD also demanded that FABRIZIO and additional defendant, AETNA, be held responsible for the defense of related state actions brought by two subcontractors of FABRIZIO against BOARD in Supreme Court, Westchester County and/or that FABRIZIO and AETNA be held responsible for any damages payable in them.

That at the outset of the trial, Judge Carter refused to admit any evidence relating to the state court actions, holding same unrelated to the federal case.

As a matter of law, the Court below erred in excluding evidence concerning the state action and should have ruled that the contractor and bonding company are responsible for the defense of the related state actions brought against the BOARD.

As previously stated, in consideration of the BOARD's forbearance to sue, AETNA agreed in the supplemental agreement (1043a) to assume the obligations for defense of the BOARD in actions brought against it by the three (3) prime contractors other than FABRIZIO.

Moreover, under the rule of the State of New York that the public may not suffer damage as a result of the illegal contract, the Court must hold FABRIZIO and AETNA responsible for any damages recovered against the BOARD in the various state court actions.

The measure of damages suffered by the public can only be determined by the actual cost to the public for the completion of the work on its school. Such damage need not eminate from the contract and need

not only relate to the items of construction called for in the contract, for, as Judge Ryan stated, the damages are those which "... are a direct consequence of the illegal contract". This holding is meant to expand the public's claim for damages, not to restrict it. The public may go beyond the agreement to press its damages, the contract being only a part of the illegality.

Had there been no illegality, there would have been no damage. There would have been no contract let and no delays. The BOARD should have been permitted to introduce evidence to show that the actions brought by the prime contractors for the costs of any delays are a direct consequence of the illegal contract between FABRIZIO and the BOARD.

There can be no question but that any recovery by the subcontractors against the BOARD would be damages which the BOARD suffered as a direct consequence of the illegal contract.

At the present time, therefore, the total damage to the public as a direct consequence of the illegal contract has not been determined. Until the BOARD's liability to the prime contractors and subcontractors is determined, it will be impossible to assess the actual cost to the public of the damage it has suffered because of the illegal contract.

As a matter of law, therefore, in order to give affect to the public policy of The State of New York, and to follow the guidelines of Gerzof that the public be made whole in every way, the Court below erred in not holding FABRIZIO and AETNA liable in the state actions brought against the BOARD by the other prime contractors and the subcontractors.

CONCLUSION

THE COURT BELOW ERRED IN DISMISSING THE COUNTERCLAIMS OF THE BOARD. THE BOARD IS ENTITLED TO JUDGMENT IN THE SUM OF $454,796.00 INCLUDING $280,796.00 FOR THE COST OF COMPLETION OF ITS SCHOOL; $171,000.00 AS THE VALUE OF LABOR AND MATERIAL ILLEGALLY EXCLUDED FROM THE CONTRACT BETWEEN FABRIZIO AND THE BOARD AND $3,000.00 FOR EXCESS PAYMENT ILLEGALLY MADE TO FABRIZIO.

THE COURT BELOW ERRED IN REFUSING TO ADMIT EVIDENCE RELATING TO THE STATE COURT ACTIONS BROUGHT AGAINST THE BOARD. THE BOARD IS ENTITLED TO A JUDGMENT HOLDING FABRIZIO AND AETNA RESPONSIBLE FOR THE DEFENSES OF RELATED STATE ACTIONS BROUGHT AGAINST THE BOARD BY OTHER PRIME CONTRACTORS AND SUBCONTRACTORS AND/OR FOR ANY JUDGMENTS PAYABLE IN THEM.

Dated: New York, New York
This 26 day of July , 1974

Respectfully submitted,

LOUIS E. YAVNER
Attorney for Defendant-Appellant-Appellee

JEFFRY H. GALLET
ROBERT I. OZIEL
On the Brief.

A 201 Affidavit of Service by Mail — LUTZ APPELLATE PRINTERS, INC.

U.S. COURT OF APPEALS: SECOND CIRCUIT

FABRIZIO & MARTIN, Appellants,

against

BOARD OF EDUCATION, Appellees.

Index No. 74-1661

Affidavit of Service by Mail

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Laurel N. Huggins, being duly sworn,

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

1050 Carroll Place, Bronx, New York

That upon the 29th day of July 1974, deponent served the annexed Appellants' Brief upon * attorney(s) for Appellee in this action, at * the address designated by said attorney(s) for that purpose by depositing 2 true copy of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.

Sworn to before me, this 29th day of July 1974

Laurel N. Huggins

Print name beneath signature

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418050
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975

LAUREL N. HUGGINS

* Max E. Greenberg, Trayman, Harris, Cantor, Reiss & Blasky-Attorneys for Appellee-100 Church St., New York.

Weinstein, Krulewitz & Weiner, P.C.-Attorneys for Appellee-144 Golden Hill St., Bridgeport, Connecticut 06604.